CONSOLIDATED CANADIAN FARADAY LIMITED

1978 ANNUAL REPORT

CONSOLIDATED CANADIAN FARADAY LIMITED

Directors:

W. Clarke Campbell,
Member of the firm of Day, Wilson, Campbell
Barristers and Solicitors.

Martin P. Connell,
Chairman of the Board
Conwest Exploration Company Limited.

John C. Lamacraft,
President
Conwest Exploration Company Limited

Jules Loeb,
General Manager, Falcon Investments Limited.

Howard A. Masson,
Mining Executive.

C. Kelly O'Connor
Vice-President Exploration and Development
Conwest Exploration Company Limited.

Robert D. H. Thorburn,
President, Venus Customs Products Limited.

Officers:

W. Clarke Campbell, Chairman of the Board.

John C. Lamacraft, President.

C. Kelly O'Connor, Executive Vice-President.

William M. O'Shaughnessy, Secretary-Treasurer.

Registrar and Transfer Agent:

Guaranty Trust Company of Canada
Toronto

Co-Transfer Agent:

Bank of Montreal Trust Company
New York, N.Y.

Auditors:

Thorne Riddell & Co.
Toronto, Ontario

Head Office:

10th Floor, 85 Richmond Street West, Toronto, Ontario

TO THE SHAREHOLDERS

Your directors are pleased to present the Annual Report for the year ended December 31, 1978. Included are the consolidated financial statements of the Company, the auditors' report and the financial statements of Madawaska Mines Limited for the fiscal period ending on that date. Also enclosed are notice of annual and general meeting, information circular, proxy statement and form of proxy.

For the fiscal year 1978 the Company elected to treat its 49% interest in Madawaska Mines Limited on an equity accounting basis. As a result earnings for the year show as 81 cents per share and for 1977 as restated, 63 cents per share.

Mineral Operations

Madawaska enjoyed a profitable productive year. From 375,533 tons of ore milled, concentrates containing 546,998 pounds of U_3O_8 were produced. Average grade of the ore was .077 and recovery approximately 95%. The overall average price, less discount, received from foreign and domestic sales of production during the year was $40 per pound U_3O_8.

The unit price for 1979 delivery is subject to escalation from the basic price of $42.00 per lb., U_3O_8, which after commercial discount presently realizes a net of $43.93 per pound. Base price for 1980 delivery is $50.50 per pound subject to commercial discount and escalation.

Presently estimated ore reserves should be sufficient to support production at current levels through at least 1985.

Natural Gas Interest

On the gas leases in the Redcliffe area of Alberta, in which your company has 11% interest, an additional nine wells were drilled and tied into the gathering system during 1978.

Exploration

The holdings of Hydra Explorations Limited and Massval Mines Limited in which your Company has a substantial interest were maintained in good standing. No direct exploration work was performed by these companies in the year under review. On Hydra's Nighthawk Lake property Pamour Porcupine Mines Limited exercised its production option and has proceeded in the sinking of a decline shaft. By year-end Hydra received a modest royalty from ore encountered and milled during this development stage.

Participation in two exploration programs managed by Conwest Exploration Company Limited was continued. No significant mineral deposits were discovered in 1978, although a number of promising prospects were and are being investigated.

The Conwest group (Conwest, International Mogul and Chimo) hold a 51% interest in a joint venture covering a large claim group in central Yukon. Essex Minerals Company holds the balance of 49%. During 1978 the exploration program included 8,300 feet of diamond drilling in 17 holes to test a variety of geophysical anomalies. Low grade lead-zinc mineralization was encountered. Geophysical surveys completed since year end have yielded additional drilling targets which will be tested by diamond drilling this summer field season. By committing to incur approximately 12.5% of the total expenditures to date your Company will acquire 25% of the Conwest group interest.

Other Interest, Lines of Business

At Fort Myers, Florida, your Company continues to operate a 51-suite Apartment Complex.

Percentage of revenue for lines of business for each of the past two fiscal years are as follows:

	1978	1977
	%	%
Mineral Operations	88	—
Oil and Gas Interest	4	22
Real Estate and Investment Income	8	78

Management Discussion and Analysis

With the adoption of equity accounting with respect to the 49% interest in Madawaska Mines Limited, the losses reported for the fiscal years 1976 and 1977 are converted to earnings. On this basis, restated, earnings per share for 1976 and 1977 are $.04 and $.63 respectively. Madawaska commenced production in the last quarter of 1976 and has continued on a profitable course throughout 1977 and 1978 as reflected in the equity figures. The increase in earnings for 1978 over 1977 is indicative of the improvement in the Madawaska production.

Increased revenue from natural gas leases is attributable to two factors; the increase in gas price and the addition of several wells brought on-stream.

Since the termination of operations at Werner Lake early in 1976, operating expenses have shown a marked decrease.

Participation in two exploration programs contributed to the increase in outside exploration expenses for these years 1976, 1977 and 1978.

The improvement in cash position in 1978 is attributable to the receipt from Madawaska of $576,000 in partial retirement of their $1,000,000 debenture held by the Company. It is anticipated the balance will be retired early in 1979.

The equity accounting treatment of the Madawaska interest and its continuing prosperity should place your Company in a retained earnings position by year-end. Current projections on the Madawaska operation indicate that it will be debt-free during the current fiscal year, with adequate working capital. Under the terms of the 1966 agreement with Federal Resources, Inc., further earnings of Madawaska are to be distributed by way of dividend or management fee to its respective shareholders. With cash available from this source, your Company proposes to establish and implement an adequate dividend policy and at the same time maintain a more aggressive exploration program.

Price Range of Common Shares

	1978	1977
First Quarter	$3.05 - 2.45	$3.75 - 2.90
Second Quarter	3.85 - 2.66	3.75 - 2.85
Third Quarter	3.80 - 3.15	3.75 - 2.60
Fourth Quarter	3.25 - 2.40	3.05 - 2.25

Copies of the Company's Form 10-K report to the Securities and Exchange Commission are available without charge upon request. Please write: Secretary, Consolidated Canadian Faraday Limited, 10th Floor, 85 Richmond Street West, Toronto, Ontario M5H 2G1.

On Behalf of the Board

W. C. Campbell

W. CLARKE CAMPBELL,
Chairman of the Board

J. Lamacraft

J. C. LAMACRAFT,
President

Toronto, Ontario,
May 28, 1979

CONSOLIDATED CANADIAN FARADAY LIMITED
(Incorporated under the laws of Ontario)

CONSOLIDATED BALANCE SHEET

AS AT DECEMBER 31, 1978 and 1977

ASSETS

	1978	1977
CURRENT ASSETS		
Cash and short term deposits	$2,238,860	$1,779,888
Accounts receivable	32,170	65,136
Prepaid expenses	9,844	7,772
	2,280,874	1,852,796
INVESTMENT IN MADAWASKA MINES LIMITED AND OTHER COMPANIES SUBJECT TO SIGNIFICANT INFLUENCE (note 2(a))	4,083,122	1,697,719
INVESTMENT IN OTHER COMPANIES (Note 2(b))	230,044	225,077
FIXED ASSETS		
Land, buildings, plant and equipment	807,427	802,715
Less accumulated depreciation	294,190	273,285
	513,237	529,430
Mining claims, rights, properties and leases, at cost	389,401	392,401
Interest in petroleum and natural gas leases, at cost less depletion (note 4)	104,107	70,378
	1,006,745	992,209
OTHER ASSETS		
Loan costs less amortization	9,601	10,827
Mortgage receivable	15,264	17,264
	24,865	28,091
	$7,625,650	$4,795,892

LIABILITIES

	1978	1977
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 64,142	$ 94,502
Current portion of long-term debt	12,420	9,492
	76,562	103,994
LONG-TERM DEBT		
10% Mortgage payable $3,999 U.S. monthly including principal and interest, maturing November 1, 1986	358,850	369,804

SHAREHOLDERS' EQUITY

CAPITAL STOCK		
Authorized — 5,000,000 shares of no par value		
Issued — 3,558,800 shares	6,665,997	6,665,997
CONTRIBUTED SURPLUS	1,506,061	1,506,061
	8,172,058	8,172,058
DEFICIT	981,820	3,849,964
	7,190,238	4,322,094
	$7,625,650	$4,795,892

Commitments and contingencies (note 7)

Approved by the Board

W. C. CAMPBELL, Director

J. C. LAMACRAFT, Director

CONSOLIDATED STATEMENT OF INCOME

YEARS ENDED DECEMBER 31, 1978 AND 1977

	1978	1977
Equity in earnings of Madawaska Mines Limited and other companies subject to significant influence (note 2(a))	$2,973,718	$2,528,998
Rental and other income	274,092	272,074
Income from petroleum and natural gas properties	135,997	77,399
	3,383,807	2,878,471
Operating expenses (including interest of $43,942; 1977, $42,058)	294,937	302,419
Depreciation and depletion	28,904	24,946
Outside exploration	197,977	300,729
Provision for decline (increase) in value of investments (note 2(d))	(16,583)	173,949
Loss (gain) on cessation of mining operations	10,428	(34,612)
	515,663	767,431
Income before undernoted items	2,868,144	2,111,040
Gain on sale of shares of subsidiary		116,801
Income taxes of subsidiary		2,852
		119,653
NET INCOME	$2,868,144	$2,230,693
EARNINGS PER SHARE	81¢	63¢

CONSOLIDATED STATEMENT OF DEFICIT

YEARS ENDED DECEMBER 31, 1978 AND 1977

	1978	1977
DEFICIT AT BEGINNING OF YEAR		
As previously reported	$5,218,477	$4,937,646
Adjustment of equity in earnings of companies subject to significant influence (note 6)	(1,368,513)	1,143,011
As restated	3,849,964	6,080,657
Net income	2,868,144	2,230,693
DEFICIT AT END OF YEAR	$ 981,820	$3,849,964

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEARS ENDED DECEMBER 31, 1978 AND 1977

	1978	1977
WORKING CAPITAL DERIVED FROM		
Reduction of advances to companies subject to significant influence (net)	600,635	$ 31,753
Proceeds from sale of shares of subsidiary less its working capital of $9,910		170,377
Sale of mine equipment and supplies		60,000
Sale of mining claim	3,000	
Reduction of mortgage receivable	2,000	2,000
	605,635	264,130
WORKING CAPITAL APPLIED TO		
Operations	92,027	215,378
Purchase of investments	703	
Additions to land, buildings, plant and equipment	4,712	14,840
Reduction of long-term debt	10,954	9,881
Additions to interest in petroleum and natural gas leases	41,729	24,472
	150,125	264,571
INCREASE (DECREASE) IN WORKING CAPITAL	455,510	(441)
WORKING CAPITAL AT BEGINNING OF YEAR	1,748,802	1,749,243
WORKING CAPITAL AT END OF YEAR	$2,204,312	$1,748,802

AUDITORS' REPORT

To the Shareholders of Consolidated Canadian Faraday Limited

We have examined the consolidated balance sheet of Consolidated Canadian Faraday Limited as at December 31, 1978 and 1977 and the consolidated statements of income, deficit and changes in financial position for the years then ended. For Consolidated Canadian Faraday Limited and subsidiaries of which we are the auditors our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. For other subsidiaries and companies subject to significant influence we have relied upon the reports of other auditors who have examined their financial statements.

With respect to Madawaska Mines Limited, a company subject to significant influence, the auditors reported in part as follows:

> The company recovers the cost of deferred charges and deferred mine development costs over the life of the ore reserves. At present, there may not be sufficient economically recoverable ore reserves to amortize these costs and, therefore, the recovery of these costs is deemed uncertain at this time.

In our opinion, subject to the realization of the costs of deferred charges and deferred mine development costs as referred to in the preceding paragraph, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and 1977 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change in accounting policy described in note 6 to the financial statements, on a consistent basis.

Toronto, Canada
March 31, 1979

THORNE RIDDELL & CO.
Chartered Accountants

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1978 AND 1977

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

These financial statements include the accounts of the following wholly-owned subsidiary companies: Bancroft Holdings Limited, I.E.C. Energy of Kentucky, Inc. (sold in 1977) Farida, Inc., and Faramines, Inc.

(b) Investments

Companies subject to significant influence

Investments held at January 1, 1973 are carried on a basis of accounting which reflect changes in equity since that date. Investments acquired subsequently reflect changes in equity since acquisition.

Other companies

Investments are carried at not in excess of cost.

(c) Fixed assets

Cost

(i) Land, buildings, plant and equipment

All land, buildings, plant and equipment are stated at cost.

(ii) Mining properties

Mining properties are recorded at cost. When the properties are considered to be permanently uneconomical they are written off.

Depreciation and depletion

(i) Depreciation

Buildings, plant and equipment, consisting mainly of the Florida real estate operation of Farida, Inc., are being depreciated on a straight line basis over their estimated useful life.

(ii) Depletion

At December 31, 1978 costs of mining claims, rights, properties and leases of $389,401 (1977, $392,401) have been deferred with the intention that they should be amortized by charges against income from future operations, and the applicable cost of participation in petroleum and natural gas projects is being amortized against related income from operations (note 4). The recovery of these costs is dependent, therefore, upon the development of economic operations.

(d) Exploration and development expenditures

Exploration and development expenditures relating to producing properties are written off as incurred. Development expenditures on non-producing properties are deferred until production commences or the property is considered to be permanently uneconomical. When production commences, these expenditures are then written off over the expected remaining life of the mine. When a property is considered to be permanently uneconomical the related exploration and development expenditures are written off.

General outside exploration is written off as incurred.

(e) Foreign currency translation

Amounts in foreign currency have been translated into Canadian dollars on the following bases:

(i) Current assets and current liabilities at the rate of exchange in effect as at the balance sheet date.

(ii) Fixed assets, related depreciation and long-term debt at historical rates.

(iii) Revenues and expenses at the average rate of exchange in effect during the year.

2. **INVESTMENTS**

(a) Investment in companies subject to significant influence

	Dumbarton Mines Limited	Hydra Explorations Limited	Massval Mines Limited	Madawaska Mines Limited	Total
	(note 5)			(note 3)	
Percentage ownership	50%	36%	44%	49%	
Balance January 1, 1977	Nil	$ 159,029	$ 147,954	$(1,121,988)	$ (815,005)
Changes during 1977					
Share of income	$ 16,274	1,200	3,416	2,508,108	2,528,998
Decrease in allowance for decline in value (see note 2(d))	15,479				15,479
Reduction of advances (net)	(31,753)				(31,753)
Balance December 31, 1977	Nil	160,229	151,370	1,386,120	1,697,719
Changes during 1978					
Share of income	12,315	4,845	2,339	2,954,219	2,973,718
Decrease in allowance for decline in value (see note 2 (d))	12,320				12,320
Reduction in advances	(24,635)			(576,000)	(600,635)
Balance December 31, 1978	Nil	$ 165,074	$ 153,709	$3,764,339	$4,083,122
Quoted market value	–	$ 619,665	$ 88,314	–	

The Company owns 1,476,448 shares of Massval Mines Limited of which 691,037 shares are held in escrow.

(b) Investment in other companies, not in excess of cost

	1978	1977
Shares in other companies (quoted market value 1978, $44,500; 1977, $39,600)	$ 44,543	$ 39,576
Shares of Prairie Potash Mines Limited	1	1
Shares and convertible debenture of Caledonia Resources Limited (formerly Henrietta Mines Limited)	185,500	185,500
	$ 230,044	$ 225,077

During 1977 the operator and principal shareholder of Prairie Potash Mines Limited decided to allow approximately one half of that company's potash leases to lapse and in view of that and the continuing uncertainty of demand for the product the investment has been written down to nominal value.

Any realization on the investment in Caledonia Resources Limited is dependent upon successful financing and commercial exploitation of its resource interests.

(c) Investment in companies for which there is a quoted market value includes instances of large share holdings where quoted market values are not necessarily indicative of amounts which might be realized if the shares were to be sold.

Included in the quoted market value is $1,500 ($1,890 in 1977) representing escrowed shares which have been valued at 50% of the quoted market value of free shares.

(d) Provision for decline (increase) in value of investments provided during the year is made up as follows:

	1978	1977
Prairie Potash Mines Limited		$ 180,000
Dumbarton Mines Limited	$ (12,320)	(15,479)
Other investments	(4,263)	9,428
	$ (16,583)	$ 173,949

3. **MADAWASKA MINES LIMITED (BANCROFT, ONTARIO)**

During 1975, pursuant to the terms of an agreement with Federal Resources Corporation dated September 8, 1966, as amended, the Company transferred its Bancroft (uranium) property to Madawaska Mines Limited (Madawaska) for a 49%

interest therein. Such interest consists of 490 of the 1,000 issued shares of Madawaska and a $1,000,000 debenture payable out of net cash flow as defined in the agreement. During 1978, $576,000 of the debenture was repaid.

The Company retroactively changed its accounting policy from the cost method to the equity method based on the concept of significant influence as defined by the Canadian Institute of Chartered Accountants in 1978 (see notes 1(b) and 6).

4. **INTEREST IN PETROLEUM AND NATURAL GAS LEASES**

Details of interests held are as follows:

	1978	1977
Participation in drilling of wells on Faraday's approximately 11% interest in certain natural gas leases in the Redcliffe area of south-eastern Alberta	$ 120,619	$ 78,890
Less depletion	16,512	8,512
	$ 104,107	$ 70,378

5. **FORMER NICKEL MINING OPERATIONS**

All operations at Werner and Bird Lake involving the Company and Dumbarton Mines Limited (Dumbarton) ceased effective June 30, 1976. Disposal of mining and milling assets commenced at that time and proceeds from the disposition of Dumbarton assets reduce its indebtedness to the Company.

6. **CHANGE IN ACCOUNTING POLICY**

The Company has changed its method of accounting for its investment in Madawaska Mines Limited from the cost method to the equity method. Comparative figures have been restated to reflect the cumulative effect of this retroactive change in accounting policy.

7. **COMMITMENTS AND CONTINGENCIES**

(a) Agreements, as amended, with Conwest Exploration Company Limited (Conwest) The Company participates in exploration programmes as follows:

(i) A 25% participation in a mineral exploration programme for a period of three years commencing January 1, 1976 at a maximum annual cost to the Company of $375,000 subject to the Company's right to elect to participate further. In addition, the Company has agreed to reimburse its co-participants in the amount of $61,300 in the event of a commercial discovery upon certain of the lands under exploration. This agreement has been renewed for a further period of three years.

(ii) A 3.125% participation in a uranium exploration programme. Effective January 1, 1979 an amendment to the Uranium Joint Venture Agreement reduced the Company's participation from 5% to 3.125%. The Company's commitment during 1979 is $75,000 and $50,000 in 1980, subject to upward adjustment based on changes in the Consumer Price Index for Canada.

(iii) The Company has elected to acquire, by incurring expenditures of approximately $190,000, a 12.5% interest in a joint project of the Conwest Group which was commenced prior to January 1, 1976.

(b) Guarantees

Madawaska Mines Limited

On October 8, 1977 the Company placed in a cash collateral account $1,000,000 in bank deposit receipts to support bank indebtedness of Madawaska with its bankers. The Company shared in the bank's security from Madawaska subject to the bank's prior realization. While these funds remained in the collateral account, the Company received from Madawaska an interest fee at the rate of 2½%. The Company's bankers stated that these funds would be released upon the receipt of monies payable to Madawaska by Madawaska's major customer as a condition precedent to the granting of export permits by the Atomic Energy Control Board. The dispute as to the export price of the uranium concentrate was settled and the bank authorized release of the collateral account effective August 23, 1978.

Dumbarton Mines Limited

The Company has guaranteed certain debts of Dumbarton Mines Limited.

(c) Long term debt

The principal amount repayable in U.S. dollars in each of the next five years is as follows:

1979	$10,472
1980	11,568
1981	12,780
1982	$14,118
1983	15,597

8. **SUBSEQUENT EVENTS**

(a) Capital stock option

Subsequent to the year end an officer and director of the Company was granted an option to purchase 50,000 shares of the Company at $2.70 per share exercisable at 10,000 shares per year on a cumulative basis for five years from the date of option.

(b) Annuity

The Company has purchased an annuity on the life of an officer and director of the Company for the lump sum of $50,000.

9. **OTHER STATUTORY INFORMATION**

Remuneration of Directors and senior officers (as defined by The Business Corporations Act) amounts to $94,199 ($104,000 in 1977).

SUMMARY OF OPERATIONS

	1978	1977	1976	1975	1974
Equity in earnings of Madawaska Mines Limited and other companies subject to significant influence	$ 2,973,718	$ 2,528,998	$ 335,339	$ 26,388	$ (171,494)
Other Income	410,089	349,473	497,778	870,140	1,276,488
	3,383,807	2,878,471	833,117	896,528	1,104,994
Operating expenses other than below	334,269	292,753	595,287	1,559,208	2,051,739
	3,049,538	2,585,718	237,830	(662,680)	(946,745)
Outside exploration	197,977	300,729	250,676	85,056	67,096
Write-down of investment in and advance to other companies	(16,583)	173,949	(169,122)	157,919	215,968
Development Expenditures				219,944	987,315
	181,394	474,678	81,554	462,919	1,270,379
Income (loss) before undernoted items	2,868,144	2,111,040	156,276	(1,125,599)	(2,217,124)
Gain on sale of shares of subsidiary		116,801		80,584	
Income taxes of subsidiary		(2,852)	512	3,500	4,500
		119,653	512	77,084	4,500
Net Income (Loss)	$ 2,868,144	$ 2,230,693	$ 155,764	$(1,048,515)	$(2,221,624)
Earnings (Loss) per share	$ .81	$ .63	$ .04	$ (.29)	$ (.65)

The above figures have been restated to reflect change in accounting policy (See Note 3 — Consolidated Financial Statements)

MADAWASKA MINES LIMITED

STATEMENTS OF FINANCIAL POSITION

ASSETS

	December 31, 1978	December 31, 1977
CURRENT ASSETS		
Cash	$ 362,100	$ 300,600
Accounts receivable	6,051,753	4,262,298
Inventories:		
Materials and supplies	1,085,723	748,118
Broken ore inventory	1,123,764	885,078
Concentrate in process	256,894	158,815
	2,466,381	1,792,011
Prepaid expenses and other current assets	115,208	74,224
TOTAL CURRENT ASSETS	8,995,442	6,429,133
PROPERTY, PLANT, AND EQUIPMENT		
Land and improvements	844,911	15,563
Buildings	2,077,040	2,202,585
Equipment	4,672,918	4,131,542
Construction in progress	96,697	1,262,173
Mining claims and leases	2,507,309	2,505,978
	10,198,875	10,117,841
Less allowances for depreciation and depletion	1,911,066	1,009,163
	8,287,809	9,108,678
Deferred mine development costs — Note B	6,410,592	6,063,406
	14,698,401	15,172,084
DEFERRED CHARGES — Note B		
Organization costs	51,673	57,143
Management fee	315,281	353,569
Agency contract	2,736,558	3,070,226
	3,103,512	3,480,938
	$26,797,355	$25,082,155

See notes to financial statements

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31 1978	1977
CURRENT LIABILITIES		
Note payable to bank		$ 2,150,000
Bank advances	$ 943,620	1,001,456
Trade accounts payable	638,066	673,564
Accounts payable to Federal Resources Corporation	546,543	365,278
Accrued expenses	349,574	1,030,058
Mining taxes payable	1,500,000	655,000
Current portion of long-term debt	7,214,608	1,007,795
TOTAL CURRENT LIABILITIES	11,192,411	6,883,151
LONG-TERM DEBT, less current portion — Note D	196,331	9,484,178
DEFERRED INCOME TAXES — Note A	3,100,000	1,310,000

STOCKHOLDERS' EQUITY

Common Stock, no par value: Authorized, issued, and outstanding 1,000 shares	3,000,000	3,000,000
Retained earnings	9,308,613	4,404,826
	12,308,613	7,404,826
	$26,797,355	$25,082,155

STATEMENTS OF EARNINGS AND RETAINED EARNINGS

	Year Ended December 31 1978	1977
Revenues:		
Concentrate sales, net of discount	$21,877,561	$17,499,632
Other income	103,904	70,905
	21,981,465	17,570,537
Cost and expenses:		
Cost of mining	8,318,844	6,554,231
Cost of milling	3,069,335	2,987,320
General and administrative expenses	1,422,314	1,015,408
Interest expense	1,134,893	1,091,567
Mining taxes	1,342,292	655,000
	15,287,678	12,303,526
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	6,693,787	5,267,011
Income taxes — deferred, less investment tax credit and savings from earned depletion claims of $447,000 in 1978 and $550,000 in 1977	1,790,000	1,198,500
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	4,903,787	4,068,511
Cumulative effect on prior year of change in method of accounting for broken ore, less applicable deferred income taxes of $66,500 — Note C		123,500
NET INCOME	4,903,787	4,192,011
Retained earnings at beginning of year	4,404,826	212,815
RETAINED EARNINGS AT END OF YEAR	$ 9,308,613	$ 4,404,826
Pro forma net income — Note C		$ 4,068,511

See notes to financial statements

AUDITORS' REPORT

Stockholders and Board of Directors, Madawaska Mines Limited, Bancroft, Ontario

We have examined the statements of financial position of Madawaska Mines Limited as of December 31, 1978 and 1977, and the related statements of operations and retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note B to the financial statements, the Company recovers the costs of deferred charges and deferred mine development costs over the life of the ore reserves. At present, there may not be sufficient economically recoverable ore reserves to amortize these costs and, therefore, the recovery of these costs is deemed uncertain at this time.

In our report dated February 17, 1978, our opinion on the 1977 financial statements was qualified as being subject to the acceptance of the sales price of concentrates by the Company's principal customer. During the year, a settlement was reached whereby the sales price of concentrates was established at the price recorded in the prior year's financial statements. Accordingly, our present opinion on the 1977 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, subject to the realization of the costs of deferred charges and deferred mine development costs as explained in the second paragraph, the financial statements referred to above present fairly the financial position of Madawaska Mines Limited at December 31, 1978 and 1977, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of January 1, 1977, in the method of accounting for broken ore as described in Note C to the financial statements.

Toronto, Ontario
February 17, 1979

ERNST & ERNST
Chartered Accountants

NOTES TO FINANCIAL STATEMENTS
Years ended December 31, 1978 and 1977

NOTE A – SUMMARY OF ACCOUNTING POLICIES

Inventories: Broken ore and concentrate in process inventories are carried at cost (first-in, first-out method) and are not in excess of market values. Material and supplies inventories are valued using the average cost method.

Property, Plant, and Equipment: Property, plant, and equipment are recorded at cost. Additions and betterments that add materially to productive capacity or extend the life of an asset are capitalized. Expenditures for maintenance, repairs, and renewals are charged to operations as incurred. Plant and equipment are depreciated principally by the straight-line method. Estimated useful lives are:

Land improvements	10 years
Buildings	10 to 20 years
Equipment	5 to 10 years

Upon retirement, abandonment, or disposal of an asset, the asset and related accumulated depreciation are eliminated from the accounts, and the related gains and losses are included in operations.

Mining Claims and Leases: Costs incurred for the acquisition of mining claims and leases are capitalized. Depletion of mining claims and leases is based on quantities of ore fed to production per year in relation to total quantities of ore available. Total quantities of ore available is defined as all ore in stockpiles at year end, estimated remaining ore reserves at year end, and ore fed to production during the year. At the time properties are retired, abandoned, or otherwise disposed of, the amounts of costs and related accumulated depreciation or depletion are eliminated from the accounts, and resulting gains and losses are included in operations.

Deferred Mine Development Costs: Costs of developing a mining claim or lease, deepening the shafts, and creating stations and pockets are capitalized. The Company has also deferred all general and administrative costs prior to September 1976 when commercial operations commenced.

Deferred Income Taxes: Deferred income taxes arise principally from timing differences in expensing certain capital costs for tax purposes at rates in excess of amortization, depletion, and depreciation for financial statement purposes. Investment tax credit and earned depletion claims are recognized on the flow-through method.

Consolidated Subsidiary: The Company is a 51% owned consolidated subsidiary of Federal Resources Corporation, and is 49% owned by Consolidated Canadian Faraday Limited.

NOTE B – DEFERRED CHARGES AND DEFERRED MINE DEVELOPMENT COSTS

At December 31, 1978, the recovery of costs in deferred charges and deferred mine development costs cannot be assured. Costs to be recovered through future sales are as follows:

Organization costs consist of legal and professional charges incurred in the formation of the Company.

A management fee for services provided, less amortization of $84,719 in 1978 and $46,431 in 1977 was allocated to the shareholders as follows:

	1978	1977
Federal Resources Corporation	$ 160,793	$ 180,320
Consolidated Canadian Faraday Limited	154,488	173,249
	$ 315,281	$ 353,569

Under the terms of an Agency Agreement dated April 16, 1975, the Company agreed to pay $3,500,000 to its shareholders in consideration of services performed by them in securing a contract for sale of uranium concentrates to an agency of the government of the Republic of Italy. The allocation to the shareholders less amortization of $763,442 in 1978 and $429,774 in 1977 was:

	1978	1977
Federal Resources Corporation	$1,778,763	$1,995,647
Consolidated Canadian Faraday Limited	957,795	1,074,579
	$2,736,558	$3,070,226

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